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SUBJECT: TREASURYS SMITH AND MEDEIROS MEETING WITH MOF A/S ZHU
GUANGYAO

Summary

[1](#)1. (SBU) Summary: Treasury Deputy Chief of Staff Taiya Smith and Strategic Economic Dialogue (SED) Political Advisor Evan Medeiros discussed preparations for the third round of the SED with Ministry of Finance Assistant Minister Zhu Guangyao October 10. Smith and Zhu agreed that the SED should focus on long-term strategic issues, identify areas of common interest, and provide guidance to other bilateral fora, while also achieving tangible results in the short-term. For the December SED meeting, the two sides agreed to work on sustainable logging, financial services, food and product safety, air pollution (SO2), transparency, investment, water pollution, and clean fuels and autos. Smith and Zhu discussed the possibility of the two countries cooperating on a long-term, ten-year joint project on a strategic topic. Both agreed to talk again after consulting with their respective sides. End Summary.

SED Principles

[1](#)2. (SBU) In discussions October 10 with Ministry of Finance Assistant Minister Zhu Guangyao, Treasury Deputy Chief of Staff Taiya Smith and Strategic Economic Dialogue (SED) Political Advisor Evan Medeiros discussed preparations for the third round of the SED to be held December 12-13 in Beijing. Smith and Zhu agreed that the SED should be guided by the following principals: a focus on long-term strategic issues, working cooperatively on areas of common interests, providing guidance to other bilateral dialogues, and working to achieve tangible, short-term results.

[1](#)3. (SBU) Smith emphasized that the SEDQs strategic focus would help both countries deal with long-term challenges, such as global climate change. Towards that end, Smith suggested that the two sides consider launching a long-term, ten-year joint project on a strategic topic. Both agreed to talk again after consulting with their respective sides.

Sustainable Logging

[1](#)4. (SBU) Smith noted that Deputy USTR Karan Bhatia had recently discussed sustainable logging with MOFCOM Vice Minister Ma Xiuhong. Smith emphasized the importance of ministries such as MOFCOM and Customs strengthening cooperation with the State Forestry Agency (SFA) which has been assigned the lead role in negotiations on a bilateral agreement on sustainable logging. She urged the Finance Ministry to help the different Chinese agencies to work together on this important issue, which affects not only Chinese wood manufacturers, but also affects global warming. U.S. negotiators would soon present the SFA with a draft cooperation agreement and hoped to finalize an agreement by the December SED. Zhu said he

would work to strengthen coordination on the Chinese side and asked that Smith keep him abreast of developments.

Financial Services

15. (SBU) FinAtt David Loevinger said the United States hoped China would continue to liberalize its financial services market. Specifically, the United States wanted China to raise the equity caps for foreign owned and joint venture financial service firms and grant licenses allowing these firms to offer a full-range of financial services. Zhu pressed Loevinger for a realistic target on equity caps and said any progress on this issue must take into account China's level of development. Loevinger said the United States wanted to see ownership limits rise to 49 percent by the end of the year and to 100 percent by the end of 2008. Zhu expressed deep skepticism that these goals could be reached in such a short time period, but said both sides should continue to exchange views on the matter.

16. (SBU) On credit rating agencies, Loevinger observed that China's SED II commitment appeared to be wavering. Chinese regulators had recently informed Moody's joint venture that it was no longer permitted to rate RMB-denominated bonds. This was a step backward and contrary to China's SED II commitment on welcoming foreign credit rating agencies.

17. (SBU) Zhu replied that the three major international credit rating agencies--Moody's, Standard & Poor's, and Fitch--had been widely criticized by the international community over its ratings of collateralized debt obligations. This led, Zhu asserted, to serious problems for the firms and a loss of reputation. Zhu said China would only open its market to foreign credit rating agencies after they had addressed their serious weaknesses in corporate governance.

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He said the United States was free to raise this issue in SED III but said he thought the issue was better addressed in the JEC. Loevinger said the U.S. position was firm and considered recent Chinese regulatory decisions as running contrary to China's SED commitments.

Food and Product Safety

18. (SBU) Regarding ongoing negotiations to conclude two bilateral binding memoranda of agreement (MOA) on food and feed and drugs and medical devices, Zhu said he had recently spoken to the head of the State Food and Drug Agency (SFDA) who had complained that the United States had changed its position after returning to Washington following the first round of negotiations in Beijing.

19. (SBU) Smith replied that the U.S. had not changed its position but was seeking greater clarity from the Chinese side regarding regulatory supervision of active pharmaceutical ingredients (APIs). It is unclear to the U.S. side whether SFDA has authority to regulate exports of such goods. If SFDA is not the right agency to oversee APIs, then the Chinese side should identify the appropriate agency. She also urged the Chinese negotiators to provide written comments on the revised draft text and to confirm when they will be able to travel to Washington to continue negotiations. Zhu replied that he would report back to Vice Premier Wu Yi on this matter and would urge SFDA to strengthen communication with HHS/FDA.

110. (SBU) Smith also noted that there were several other agreements related to food and product safety currently under discussions. She said it would send a positive signal if all of these agreements could be finalized and announced by the December SED.

SO2 Cap-and-Trade

111. (SBU) Smith noted that in his meeting with EPA Administrator Johnson, NDRC Vice Chairman Xie Zhenhua was positive on the prospects of launching a national cap-and-trade emissions trading system for SO2. EPA is currently working on a joint abatement study

with ChinaQs SEPA and would have policy recommendations by the December SED. Smith said it would be a strong demonstration of U.S-China cooperation if China was prepared to announce an SO2 emissions trading system at SED III. Zhu said the two sides should continue discussions on this issue.

Transparency

¶12. (SBU) On transparency, Smith said preparations were going well for two seminars on administrative rule-making and licensing, the first to be held in Beijing at the end of October and the other in late November in Washington. The United States was also looking for China to implement its APEC transparency commitments and adopt a national policy on public notice-and-comment period. Zhu recalled that both sides struggled during the May SED to come up with a common approach on this issue and urged both sides to prepare carefully for the upcoming SED.

Investment

¶13. (SBU) Smith informed Zhu that Deputy USTR Bhatia had spoken to MOFCOMQs Madame Ma about prospects for concluding a bilateral investment treaty (BIT). U.S. officials planned to have further discussions on this issue in Washington and would then discuss with the Chinese side how best to move forward. Zhu said it would be important to make progress on this issue and that both sides should do more to improve trust and confidence in the investment environment. He said that some examples of successful investments on both sides would demonstrate the value of open investment policies. Smith suggested that U.S. and Chinese scholars could collaborate on case studies of both successful investments and those that ran into difficulties, such as the CNOOC case.

Water Pollution

¶14. (SBU) Noting ChinaQs interest in cooperating on water issues, Smith said the United States would look into strengthening the existing agreement between EPA and the Ministry of Water Resources.

Autos/Low Sulfur Fuel

¶15. (SBU) Responding to ChinaQs interest in discussing clean fuels

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for automobiles, Smith said EPA had worked with Chinese officials on low sulfur fuel issues for many years. Zhu said China welcomed cooperation on this issue and said he hoped both sides could do more work in this area for the December SED.

Environmental Tariffs

¶16. (SBU) Regarding lowering tariffs on environmental goods and services, Zhu asked if the United States had any further ideas on how to discuss this issue in a bilateral context. He suggested both sides consider building on President HuQs proposal at APEC to establish an Asia Pacific information network on environmental tariffs. Smith said she would discuss with her colleagues in Washington on how best to move forward.

Satellites

¶17. (SBU) Zhu raised the issue of renewing the expired bilateral satellite launch cooperation agreement, noting that JCCT discussions on this topic had not made progress. Smith replied that this was a sensitive issue and must be approached carefully.

Accounting Standards

¶18. (SBU) Zhu said Chinese companies found it burdensome to comply

with U.S. accounting standards when trying to list shares on U.S. stock markets. He asked if U.S. regulators could accept Chinese accounting statements which comply with international standards. Smith noted that U.S. accounting standards are more rigorous than international standards Q having been strengthened following the passage of Sarbanes-Oxley legislation and that U.S. regulators applied the same standard to all foreign firms. Loevinger suggested that MOF Vice Minister Li Yong meet with SEC officials when he is in Washington to attend World Bank meetings.

119. (U) Smith and Medeiros cleared this cable.

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